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Estimates Memorandum

# Military Implications of China's Economic Plans (U)

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DEFENSE INTELLIGENCE ESTIMATES MEMORANDUM

MILITARY IMPLICATIONS OF CHINA'S ECONOMIC PLANS (U)

[REDACTED] This estimate projects China's military expenditures to the end of the century, based on projections of likely economic and budget growth. The estimate examines the military implications of these spending projections, assessing the prospects for China's military modernization program and defense posture.

(U) This Memorandum has not been coordinated with the Service Intelligence Chiefs.

(U) Comments or questions should be referred to the author [REDACTED] Directorate for Estimates, who can be reached on [REDACTED] number is [REDACTED].

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## MILITARY IMPLICATIONS OF CHINA'S ECONOMIC PLANS (U)

### KEY JUDGMENTS

Although China's fifth Five-Year Plan is based on conservative growth targets of 4-5 percent, actual economic performance over the past several years has outstripped these goals. If, as now seems likely, China's recent trend of buoyant economic growth continues in 1984 and 1985, then we can expect 1980s average real growth rates somewhat higher than planned, probably between 5 and 6 percent. However, China would need to achieve even higher real growth rates in order to realize its end-of-the-century goal of quadrupling the gross value of industrial and agricultural output. We estimate that basic constraints will restrict China's long-term real growth to only a little more than 5 percent.

China's projected economic growth will enable Beijing to sustain a defense expenditure larger than the current level, estimated to be about 36 billion yuan. Our best estimate is that annual defense expenditures will reach over 46 billion yuan by 1990 and 75 billion yuan by 2000, assuming the Chinese economy grows at a steady 5 percent annually. If we assume a less likely higher rate (6-7 percent) of economic growth, they could reach over 48 billion yuan by 1990 and over 92 billion yuan by 2000.

Nevertheless, the continuation of China's present policies restricting defense expenditures in order to free resources for basic economic growth will restrain the pace of China's military modernization program. Although additional funds will be available for selected high priority programs, increases in overall defense output will continue to be limited. The costs of a new generation of weapons may grow as fast, if not faster, than expenditures. Training, maintenance, and operating costs will also escalate as new weapons and equipment are introduced. Although technology acquisitions will enhance China's capability to produce improved military equipment and weapons in limited numbers, the budget resources necessary for significant re-equipment of China's military forces with state-of-the-art equipment will not exist through the 1990s. Thus, for at least the next decade, the bulk of China's forces will continue to be equipped largely with obsolete weapons.

China will remain relatively inferior to both superpowers--but will develop an increased regional capability--during the remainder of this century. China will not be able to field sufficient quantities of advanced weapons to match the threat posed by China's main military adversary, the Soviet Union. Barring a Sino-Soviet arms agreement or a massive Western-assisted rearmament program, China's position relative to nearby Soviet forces may not be significantly better than at present, and its posture could well deteriorate depending on the pace and scale of Soviet military improvement programs in the Far East.

## MILITARY IMPLICATIONS OF CHINA'S ECONOMIC PLANS (U)

### DISCUSSION

1. (U) Background. China's 6th Five-Year Plan (FYP), covering the years 1981 through 1985, was published in June 1983.\* This plan projected a moderate industrial and agricultural growth rate of 4 to 5 percent a year. State budget expenditures were planned to rise from 121.2 billion yuan\*\* in 1980 to 130.4 billion yuan in 1985, a modest 1.5 percent yearly increase. The plan was intended to remedy problems stemming from unacceptably high budget deficits and high rates of inflation resulting from earlier attempts to stimulate economic growth.

2. (U) The basic objective of the 6th FYP is to lay the foundation for balanced economic growth by eliminating major energy, communications and transportation bottlenecks. The plan, for example, recognizes that acute energy shortages represent an especially serious threat to future economic development. As a result, the plan calls for the reduction of energy consumption through conservation measures, investment in more efficient industrial equipment, and restrictions on the growth rate of heavy industry, the most intensive energy consuming sector of the economy. The plan also channels more investment into the development of new energy sources to meet the demands of future economic growth. The main thrust of the 6th FYP plan, therefore, is to provide the groundwork for more rapid, but well-balanced, growth later on.

3. (U) China's leaders expect to continue along this path through the remainder of the decade, providing the basis for an upsurge of more rapid economic growth in the 1990s. They believe that the growth rate will rise if the economy continues to benefit from proper policy direction, system reforms, and large-scale infusions of foreign technology and capital. The ultimate target is to quadruple the gross value of industrial and agricultural output by the end of the century.

4. (U) Although the 6th FYP is based on conservative growth targets of 4-5 percent, actual economic performance over the past several years has outstripped these goals. The Chinese government has reported that industrial growth in 1983 (gross output value) was 10.5 percent, with heavy industry rising by 12.4 percent. The gross value of agricultural output rose by an

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\* The publication in 1983, midway through the planning period, is not unusual in China. The plan was initially promulgated in December 1982, but its basic tenets have been reflected in Chinese economic decisionmaking since 1981. In his report to the 12th Party Congress on 1 September 1982, General Secretary Hu Yaobang mentioned the 6th FYP and incorporated some of its basic premises.

\*\* One yuan equals approximately \$0.44 US.

impressive 9.5 percent.\* Premier Zhao Ziyang recently announced that last year's output in both sectors reached or exceeded, two years ahead of schedule, the targets set for 1985 in the 6th FYP.

5. Sustaining this fast paced growth for the next decade and a half will be difficult because of fundamental constraints in energy, transportation, management, worker skills and incentives, and industrial organization. Progress toward alleviating these constraints is being made, but to date constitutes only a beginning toward resolving many intractable problems. Since agricultural output depends in part on the weather, last year's extraordinary success will not likely be repeated often. Long-term agricultural growth rates probably will average only about 4 percent or less, an improvement over earlier decades but considerably less than last year. A high rate of industrial growth probably will not be possible over the long-term without a major breakthrough in developing new energy resources.

6. China's planners envisage that by the 1990s a sharp increase in energy growth--when offshore oil production and other coal, nuclear, and hydroelectric projects come on line--will occur to support more rapid sustained industrial growth. These hopes are probably overly optimistic. China's offshore oil resources are beginning to appear less promising than once thought, while the prospect for major progress in eliminating inefficiency in the use of energy resources is problematic. If the promise of new domestic energy resources were to be unfulfilled, or only partially fulfilled, China would be faced with the prospect of rising imports of essential energy supplies to sustain its rapid industrial growth. The result would be a deterioration in China's balance of payments posture and a steady encroachment on existing foreign exchange surpluses, thus curtailing the funds needed to finance imports of modern technology.

7. Even in the unlikely event these constraints were overcome, two other essential conditions for long-term economic progress must also be met. These are the continuation of a stable government committed to steady, pragmatic economic growth policies; and the avoidance of an immediate foreign threat to vital national interests which could force the diversion of resources and attention from modernization programs.

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\* As a baseline for comparison, gross industrial output grew at an annual average real rate of 11 percent in 1952-79; and agricultural output grew by an annual average of 3 percent during the same period. Chinese statistical information, while basically valid, retains a measure of unreliability due to its special idiosyncrasies and occasional inconsistencies. Its use requires caution and some adjustments to obtain accurate interpretation in Western statistical terms. Although the quoted figures are no exception, they constitute general indications of 1983 economic performance.

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8. **Growth Rate Forecasts.** If, as now seems likely, China's recent trend of buoyant economic growth continues in 1994 and 1995, then we can expect 1990s average real growth rates somewhat higher than planned.\* For the next year and a half the overall economy almost certainly will grow at a rate exceeding 5 percent, and possibly by as much as 6 percent.\*\* However, China would need to achieve even higher real growth rates in order to realize its goal of quadrupling the gross value of economic output by the end of the century.\*\*\* We judge that, because of the numerous constraints against rapid economic expansion, China will not be able to maintain a high average annual real growth rate to the year 2000.

9. **High-Growth Scenario.** A high-growth scenario assumes an improving economic growth rate, averaging 6-7 percent, until the year 2000. This scenario would reflect an agricultural increase of 4 percent a year, success or major progress in overcoming most long-term constraints, and a continuation of the existing policy orientation favorable to economic growth. For illustrative purposes, we project real-growth rates of 5 percent during the 7th FYP (1986-90), 6.5 percent in the 8th FYP (1990-95), and 7 percent in the 9th FYP (1995-2000). At these rates, China's economic output would rise to over 2,500 billion yuan by the end of the century, an impressive achievement, but still slightly shy of the announced target.

10. **Best Estimate.** Our best estimate reflects agricultural increases closer to the historic norm of 3 percent, moderate progress in easing most major constraints, with continuing problems in some sectors--such as energy--and possible economic policy readjustments stemming from succession problems following the death or incapacitation of Deng Xiaoping. A growth rate of about 5 percent annually would reflect the existence of such barriers to progress. Although this amount of growth would represent good performance by most standards of measurement, China would nevertheless fall considerably short of achieving its end of the century goal. As an illustration, if China were to maintain a moderate 5 percent real growth rate to the end of the

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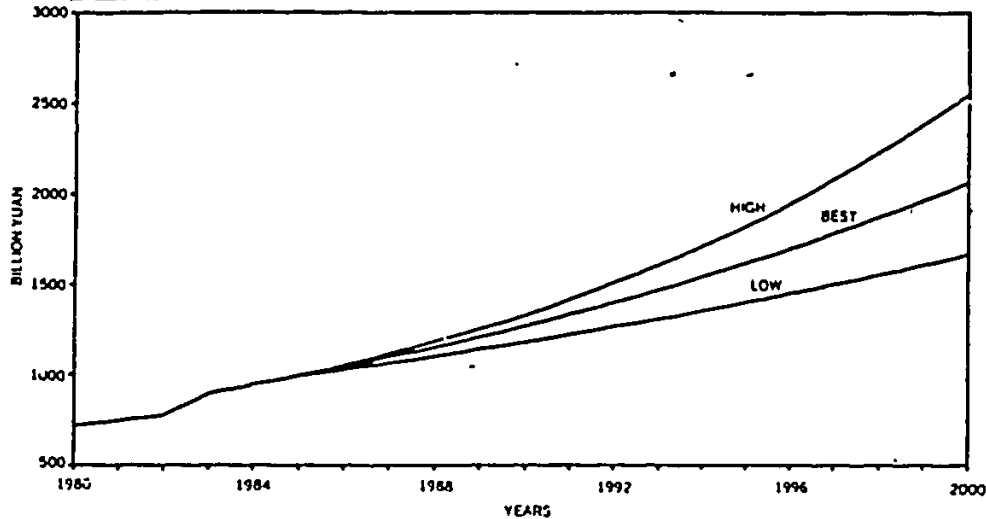
\* According to the 1994 annual plan endorsed in May by the National People's Congress, the target for industrial growth remains at 5 percent. Actual performance in the first four months of 1994 shows industrial output rising by 11.7 percent, indicating the economy is still over-heated.

\*\* Two private sector sources have recently projected a 1994 real growth rate of 5.5 percent and 5.7 percent respectively, and a 1995 real growth rate of 5.2 percent.

\*\*\* China could reach the goal of quadrupling the gross value of economic output by 2000 if real growth rates were to average about 7.2% annually for the twenty year period beginning in 1981. PRC statistical treatment of inflation is not consistent, however, and it is possible that the end-of-century goal will be measured in current rather than constant figures. In this sense the goal is more political than truly economic.

century, output (gross value of industrial and agricultural output) by the year 2000 would reach only 2,100 billion yuan, roughly tripling the 1980 level.

PROJECTED ECONOMIC GROWTH TO 2000



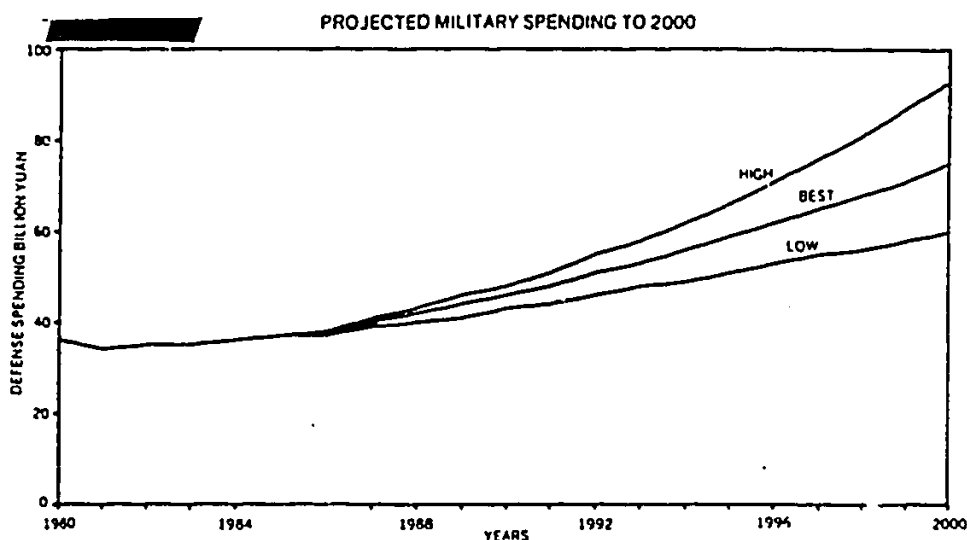
11. Low-Growth Scenario. A low-growth scenario would reflect a slide toward more modest rates of progress due to a combination of factors such as a series of weather-related agricultural setbacks, a ballooning rate of population growth, failures in energy resource development, a rapid deterioration in balance of payments caused by rising energy and food imports, higher inflation and unemployment, and more severe economic policy fluctuations resulting from a potentially fractious succession struggle. Under a combination of such circumstances, economic growth could slow to around 3.5 percent annually. Such modest progress, if continued over the period of this estimate, would yield an economy in 2000 roughly two and a third times its 1980 level, leaving China far short of achieving its development goals.



12. **National Budget Estimates.** We project that China's national budget will grow about as rapidly as the expected growth rates in domestic economic output. State budget expenditures climbed rapidly last year, reaching the 6th FYP target for 1995, and are now forecast to rise another 5.9 percent this year, indicating a trend toward budget growth on a par with the rate of economic expansion.

13. **Military Spending.** China's current five year plan provides for an average yearly defense budget expenditure of 17.7 billion yuan, about 14.5 percent of the total state budget. To date, announced defense expenditures have remained close to this average figure.\* However, China's announced defense spending figures are not comparable to those in Western military budgets, since they probably do not include spending for military RDT&E, capital construction, and some other categories. DIA estimates that actual Chinese defense spending, adjusted to include these categories, may be about twice the reported figures, thus representing about 28 percent of the actual national budget in the first three years of the 6th FYP.

14. **Military Spending Forecasts.** We expect China's level of defense spending will change only marginally in 1984 and 1985, but will decline slightly as a share of the total budget to about 26 percent, continuing a trend noticeable since 1977. We believe, however, that this gradual erosion of the defense share of budget allocations will not become permanent, but that military spending will begin to assume a more stable share of the national budget under future five-year plans. We forecast that defense expenditures will likely maintain an average 25-percent share of future national budgets.



\* Announced defense expenditures in the first three years of the 6th FYP are 16.8 billion yuan (1981); 17.6 billion yuan (1982); and 17.7 billion yuan (1983). Planned 1984 defense expenditures are 17.87 billion yuan.

15. We expect defense expenditures will grow proportionally to anticipated increases in budget outlays after 1985. Although the defense sector will continue to be accorded a low priority in China's overall modernization plans, economic growth will gradually enable China's leaders to spend more for defense. Based on our best estimate of 5-percent average annual real growth, military expenditures likely will reach 46 billion yuan by 1990 and 75 billion yuan by 2000. They would reach over 40 billion yuan by 1990 and over 92 billion yuan by 2000, if we assume high (6-7 percent) economic growth. In a low-growth scenario, military spending would be constrained to about 43 billion yuan by 1990 and about 60 billion yuan by 2000.

16. Military Implications. On the basis of our best estimate, we project that the current curbs on defense production and procurement will continue for the next two years. The prospect of gradually increasing defense expenditures thereafter likely will lead to a modest increase in overall defense output later in this decade, followed by a more pronounced upturn in the 1990s. Additional funds will be available for selected high priority programs, such as strategic offensive systems. However, the overall pace of change will be slow.

17. The most significant change over the next decade will result from China's steady acquisition of processing technology and know-how in electronics, computer technology, instruments, and component production. These acquisitions will enable China to make improvements in selected weapons, such as missile guidance systems, and in aircraft and naval electronics.

18. The development and production of a new generation of conventional weapons incorporating the most modern technologies will require vastly increased outlays for military research, development, testing, and evaluation. The production costs of sophisticated weapons will soar, as they have elsewhere in the world, causing sharp increases in procurement spending. Budget constraints will force the Chinese to concentrate on acquiring only a few selected new systems that are most critically needed. However, the long lead times associated with the design and development of new weapons and equipment will force the Chinese to retain and upgrade some existing major systems, as they are currently attempting to do with their tanks, LUDA-class destroyers, and F-7/FISHBEU and F-3/FINBACK fighters. Even so, these weapons platforms of older design will have limited capabilities, survivability, usefulness and length of service, making the upgrading of older systems an interim solution at best.

19. For at least the next decade, the bulk of China's conventional forces will therefore continue to be equipped largely with outmoded weapons. A growing, but still relatively small proportion of the overall forces will be equipped with newly produced weapons and equipment, whether of advanced design incorporating the latest technology or upgraded versions of older designs. As this replacement process continues, the training, maintenance, and operating costs associated with the newer equipment will also escalate. We believe the Chinese will eventually reach a point where the need to cut costs will lead them to consider reducing the size of some of their forces by eliminating those equipped with obsolete hardware in order to concentrate resources on the newly equipped formations.

20. [REDACTED] Especially in the Air Force, budgetary constraints will likely encourage the retirement of a portion of China's large inventory of obsolete fighters in order to maximize limited available funds for purchasing, operating, and maintaining expensive new models. Hence, we will not likely see one-for-one replacement of old airframes. As a result, the Air Force will rely increasingly on smaller numbers of high-performance aircraft to perform the missions and roles currently assigned to large numbers of obsolete ones.

21. [REDACTED] Such reductions probably will not occur in China's ground forces during the period of this estimate. The army will continue to rely on large masses of available manpower, and mechanization of the infantry will be a slow, selective process. In an effort to counter Soviet superiority in armor, mobility, and firepower, the Chinese will improve the combat capability of their ground forces, but these improvements will perforce include many low-cost alternatives to large-scale qualitative upgrades, a trend evident today in the emphasis on education and training improvements. Expenditures for necessary equipment acquisitions will be selective and concentrated in key mission areas, for example, in antitank and ground-based air defense. Since budget constraints will slow the pace of this modernization program, Chinese ground forces probably will not acquire sufficient mobility or firepower to match Soviet capabilities before the end of the century.

22. [REDACTED] However, the trend toward increased professionalization will continue, resulting in improved command, control, and communications, logistics, and overall warfighting capabilities. The gradual development of a professional military establishment probably will be accompanied by an increased emphasis on a well-trained reserve force to provide a manpower pool for potential wartime expansion.\* Although the militia will be continued, it probably will receive decreasing emphasis. Due to budgetary constraints and the size of China's forces, progress will continue to be incremental. Although we do not expect the existing concept of People's War to be abandoned by the 1990s, we believe there will be a gradual development of new doctrine and tactics in line with the trends outlined above.

23. [REDACTED] Because China's naval forces will receive a lower priority than the ground or air forces, the budget constraints will limit severely the pace of naval modernization. Selective improvements in antisubmarine warfare, shipborne air defense, and electronic warfare will continue. However, these improvements will be introduced to only a small number of existing fleet units, and new construction will continue at a measured pace. Therefore, the size and capabilities of China's naval forces will remain inadequate to counter the threat posed by the Soviet Pacific Fleet.

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\* China's recently adopted Military Service Law establishes the basis for this development.

24. [REDACTED] Over the next decade and a half, there will be some important changes within China's military budgets, reflecting changing investment needs:

- The share of military spending allocated to RDT&E will increase steadily in the next ten years in response to the need to utilize newly acquired technologies in the development of China's next generation weapons.
- The share allocated to procurement probably will remain steady for the near term, if it does not actually decline, but will then begin to increase markedly toward the end of this decade as the ability to manufacture more advanced weapons is acquired and as programs to purchase advanced components begin to come on line.
- The percentage of the budget devoted to training probably will increase as newer, and more complex, weapons are procured later in this decade.

Other categories of defense spending probably will remain more stable, or perhaps decline as a share of the budget:

- Personnel expenditures may actually decline over the near term as the size of China's armed forces are trimmed, although individual pay and allowances may increase as incentives and bonuses are employed in support of the professionalization program.
- Equipment O&M will show little change until new generations of equipment begin to be deployed in the 1990s with more advanced, and hence more complex, components and subsystems.
- Capital construction spending probably will remain at a constant share of the budget, although some increases could be registered in the 1990s in association with new equipment purchases.

25. [REDACTED] In general, the most flexible military budget category is procurement. At the present time, China's reduced level of military spending (down from the highs registered in 1979, which were due to the costs of China's brief conflict with Vietnam) is due mainly to procurement cutbacks. These cutbacks generally reflect priorities favoring economic growth at the expense of military spending, and reduced production goals for obsolete equipment.

26. [REDACTED] Except for the nuclear forces, which appear to be claiming an increasing share of funds for ICBM deployment and SSBN/SLBM force development, China's procurement priorities will continue to aim at overcoming identified military deficiencies measured against the Soviet threat. China's most critical deficiencies stem from inadequate C3; weaknesses in ground force combat equipment, including anti-armor weapons and ground-based air defense missiles; and from its inability to develop and produce a new generation of military aircraft capable of maintaining air superiority over a potential battlefield against Soviet air power. Chinese efforts will be directed at indigenously producing state-of-the-art anti-tank and anti-air weapons.

together with attack helicopters armed with anti-tank missiles and at designing and producing advanced military aircraft, including the capability to manufacture advanced engines, avionics, and associated weaponry. China probably will allocate a very large share of its available RDT&E funds in these priority areas during the remainder of this decade. Procurement spending for satisfying these needs probably will show significant increases in the 1990s. We believe the Chinese will attempt to meet only a small part of their requirements through foreign purchases of major weapon systems, and will economize by buying technology for domestic production.

27. ■ Aside from fiscal constraints, other weaknesses in China's defense industries will continue into the 1990s. Weaknesses in key technology areas, including metallurgy, computers and electronics, will constrain the pace of defense improvements in aircraft engines, radars, and tactical missiles (ATGM, air defense, and theater nuclear), although technology acquisitions in these areas will lay the groundwork for subsequent progress. We estimate that China will not be able to manufacture second generation ATGM's (equivalent to the I-TOW) until the late 1980s, or advanced aircraft engines (in the class of today's frontline US aircraft engines) until the mid- to late-1990s, assuming appropriate development contracts are signed this year or next. Heavy current emphasis on technology acquisitions in electronics, computers, and associated production know-how will lead to modest improvements in missile capabilities in the next several years, with accelerating progress in the late 1980s and early 1990s.

28. ■ Implications for the United States. We believe that the continuation of China's present policies restricting defense expenditures in order to free resources for basic economic growth will restrain the pace of China's military modernization program in the short term, while improving the industrial base for long-term military growth. Although technology acquisitions will enhance China's capability to produce improved military equipment and weapons in limited numbers, the budget resources necessary for significant re-equipment of China's military forces with state-of-the-art equipment does not exist, and will not exist through the 1990s.

29. ■ The expense of increasingly complex modern weapons will prevent China from fielding sufficient quantities of advanced conventional weapons to neutralize the threat posed by China's main military adversary, the Soviet Union. However, we perceive that China's limited strategic deterrence will continue and perhaps be modestly enhanced by the 1990s. Although China's economic base and technology levels will grow in size and sophistication, limited financial resources will still leave China relatively inferior to the superpowers--but will permit the development of an increased regional capability--throughout the remainder of this century. Bringing a Sino-Soviet arms agreement or a massive Western-assisted rearmament program, by the end of the century China's posture relative to nearby Soviet forces may not be significantly better than at present. Moreover, depending on the pace and scale of Soviet military improvement programs in the Far East, China's position could well deteriorate.

[REDACTED]

30. [REDACTED] We believe China's foreign policies will continue to aim at managing the Soviet threat by seeking reduced tensions in order to minimize the chances of a hostile confrontation. The Chinese wish to avoid a high-risk situation which might disrupt economic development plans by requiring sharp spending increases for military procurement. China's foreign policies will continue to serve the interests of domestic economic development, which will remain China's highest priority. The absence of an immediate foreign threat will permit China to concentrate more fully on achieving its modernization goals.